IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 69 of 1988

For Approval and Signature:

Hon'ble MR.JUSTICE B.C.PATEL Sd/-
and
Hon'ble MR.JUSTICE D.A.MEHTA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

ASHWIN VANASPATI INDUSTRIES

Versus

COMMISSIONER OF INCOME TAX

Appearance:

MR HEMANI FOR MR SN SOPARKAR for Applicant.

MR BB NAYAK FOR MR MANISH R BHATT for Respondent.

CORAM : MR.JUSTICE B.C.PATEL
and
MR.JUSTICE D.A.MEHTA

Date of decision: 25/01/2002

CAV. JUDGEMENT

(Per : MR.JUSTICE D.A.MEHTA)

1 The applicant-assessee had proposed the following four questions of law under Section 256(1) of the Income Tax Act,1961 (hereinafter referred to as 'the Act') :

1 "Whether, on the facts and in circumstances of the case the Tribunal was right in law in invoking the provision of explanation 3 to Sec.43(1) of the I.T.Act,1961 inspite of fact that the provisions were not invoked by the authorities below ?"

2 "Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the provisions of Sec.43(1) expl.3 of I.T.Act,1961 were applicable to the facts of the case inspite of fact that sufficient evidences like valuation report, dissolution deed etc., in support of valuation of assets were before the Tribunal ?"

3 "Whether, on the facts and in the circumstances of the case, Tribunal was right in law in holding that onus of establishing that the purpose of transaction was to reduce the tax liability was discharged by the department ?"

4 "Whether, on the facts and in circumstances of the case, the Tribunal was right in law in holding that the original cost of the assets of the dissolved firm without ascertaining the market value of the assets on the date of dissolution ?"

2 However, the Income Tax Appellate Tribunal, Ahmedabad Bench, "C" has raised and referred the following question, which in its opinion takes within its sweep all the aspects raised by the proposed question :

"Whether, on the facts and circumstances of the case, and having regard to the relevant provisions of the Income-tax Act,1961, the assessee was entitled to claim depreciation on

the enhanced value of the assets ?"

3 The assessee is a Private Limited Company carrying on business of manufacturing vegetable ghee and various types of oil. The assessment years are 1980-81 and 1981-82 and the relevant accounting periods are years ended on 30/6/1979 and 30/6/1980 respectively.

4 The controversy arises in backdrop of the following circumstances :

[a] Certain members of Thakkar Family entered into a partnership on 28/10/1961 to carry on business in the name of M/s. Ashwin Vanaspati Industries (hereinafter referred to as the 'firm'). The firm carried on business with minor changes in the constitution from time to time till October,1976.

[b] On 21/10/1976 the applicant assessee was incorporated with all the shareholders being erstwhile partners viz. belonging to Thakkar Group.

[c] On 24/10/1976 the applicant entered into a partnership with Thakkar Group and joined the running business of the firm M/s.Ashwin Industries.

[d] On 30/7/1978 the firm got various assets valued by one Shri R.M.Sheth, a registered valuer.

[e] On 5/8/1978 all the shares held by Thakkar Group of the assessee Company were transferred to one Patel Group and Thakkar Group gave up the control and management of the applicant.

[f] On 6/8/1978 the partners of the firm entered into a dissolution deed which was made effective from 31/7/1978.

5 Thereafter, the assessee Company filed return of income on 30/6/1980 showing loss of Rs.21,45,604/- for assessment year 1980-81. In the return of income filed by the assessee Company depreciation was claimed on enhanced value of factory building, residential building and plant and machinery, as according to the assessee Company that was the actual cost incurred by the assessee for acquiring the said assets. The Income Tax Officer

held that the dissolution of the firm which had taken place during the accounting period was just a method to defraud the revenue by transferring all assets of the firm to the assessee company and this device was adopted for the purpose of claiming higher depreciation. The reasons which weighed with the income tax for arriving at this conclusion were :

[i] The assessee Company had been incorporated with the main object of " to acquire and take over from Ashwin Industries, a partnership concern, land and Bldg., and all other assets".

[ii] All machineries and assets had been taken over as a running concern. There was no shifting of machineries and various assets. Instead of partnership concern running the machineries, the Company had started running machineries.

[iii] That, it was settled law that a partner acquiring assets on dissolution of the firm did not amount to transfer.

[iv] All the partners who were interested in the firm were interested in the Company.

6 This stand adopted by the Income Tax Officer was approved by the Inspecting Assistant Commissioner, Baroda Range-I, Baroda by stating that it was settled law that a partner acquiring assets on dissolution of a firm did not result in any transfer, and hence, it was not possible to adopt fair market value of the assets at the time of the dissolution as there was no purchaser or seller. He further placed reliance on Explanation 6 to Section 43 of the Act and applying the analogy of the said provision confirmed the view of the Income Tax Officer that the assessee was entitled to depreciation only on the written down value of the assets and not on the enhanced value as claimed by the assessee. For the next assessment year 1981-82 also the claim of depreciation was restricted on the written down value.

7 The assessee preferred appeal before the C.I.T.(Appeals), Baroda who allowed the appeal holding that even if there was intention since inception that the assessee would take over running business of the firm that would not decide the issue because the intention was only as regards taking over of the business, but no collusion was proved or alleged in regard to the valuation of the assets. The C.I.T.(Appeals) further held that due to enhanced valuation the assessee Company

did not get effective benefit but it was the outgoing partners who actually benefitted in terms of actual moneys received. As regards the stand taken by the IAC that on dissolution there was no transfer, the C.I.T.(Appeals) relying upon the ratio of the Supreme Court decision in case of Kaluram Govindram vs. C.I.T., 57 ITR 335 held that in similar circumstances this particular aspect was urged by the department and rejected by the Supreme Court. The C.I.T.(Appeals) further held that in case any part of total increase in value of the assets which were received by the assessee on dissolution would be available to the assessee company, the same would not constitute cost in hands of the assessee company.

8 Against the aforesaid consolidated appellate order the revenue preferred appeal before the Tribunal. The Tribunal for the reasons stated in paragraphs 12 and 13 of its order dated 23/6/1987 held that the amount of Rs.37,94,680/- paid by the assessee to Thakkar Group could not be said to have been paid in respect of the assets on which the assessee claimed depreciation. According to the Tribunal the amount paid by the assessee was also in respect of goodwill, tenancy rights, etc. i.e. in other words, the amount was paid for acquiring running concern of the erstwhile firm in which the assessee was a partner alongwith Thakkar Group. This view was adopted by the Tribunal by referring to some of the clauses of the dissolution deed.

9. The Tribunal also alternatively held that even if the enhanced value had been paid to Thakkar Group for acquiring only three assets by virtue of Explanation 3 to Section 43(1) of the Act, the Income Tax Officer was fully justified in holding that purpose of transfer of such assets, directly or indirectly to assessee, was reduction of liability to income tax by claiming depreciation with reference to enhanced costs. The Tribunal referred to various figures of carried forward business loss, carried forward unabsorbed depreciation and investment allowance in support of its aforesaid conclusion.

10. Mr.Hemani, learned Advocate appearing on behalf of Mr.S.N.Soparkar for the applicant assessee assailed the order of the Tribunal stating that the Tribunal could not have suo motu invoked Explanation 3 to 43(1) of the Act to uphold the assessment order. It was further submitted that the Tribunal had gone beyond the findings recorded by the Income Tax Officer and made out a new case altogether. That the Tribunal had erred in holding

that change in the management/control would not make any difference to the transaction and this was an incorrect assumption in law. He also submitted that, even assuming that Explanation 3 to Section 43(1) of the Act could be invoked, yet on facts and in law same would not be applicable because, firstly, the provision required that there was a transfer of assets from one person to another, while in the present case on dissolution there was no transfer. He further submitted that even if it was assumed that there was transfer of the assets, the provision required that the main purpose of the transfer must be reduction of tax liability and the satisfaction for the same had to be that of the Income Tax Officer and the Tribunal could not have substituted its satisfaction in absence of any such satisfaction recorded by the Income Tax Officer.

11 Mr.Hemani also submitted that actual cost to the assessee had to be taken into consideration and not the cost in hands of the vendor. That in the case of partition or dissolution cost in hands of the person who acquired the assets would be market value on the date of such partition or dissolution. That the Section categorically stated that the main purpose of transfer was reduction of tax liability and if the reduction of tax liability was incidental to the transaction, which was purely a commercial transaction, the provision could not not be applied in the case of the assessee.

12 As against this, Mr.B.B.Nayak, learned Counsel for the revenue submitted that for appreciating the transaction and the dissolution deed in true perspective it was necessary to look at the substance of the matter and not the form of the document. That the assessee had purchased a running business and as rights of other partners got extinguished it would fall within the definition of transfer under Section 2(47) of the Act. That even otherwise there was a transfer (as understood) within the meaning of the general. Mr.Nayak further submitted that in case it was held that there was no transfer on dissolution it was apparent that same business continued and hence depreciation could be allowed only on the basis of written down value. That in any view of the matter, transaction amounted to the assessee company purchasing a running business from other partners.

13. Provision of Section 43(1) and Explanation 3 to the said Section as are necessary for the purpose of deciding the controversy at hand read as under :

"43. In sections 28 to 41 and in this section, unless the context otherwise requires -

(1) 'actual cost' means the actual cost of the assets to the assessee, reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority :

xxx xxx xxx

Explanation 3 : Where, before the date of acquisition by the assessee, the assets were at any time used by any other person for the purposes of his business or profession and the Income-tax Officer is satisfied that the main purpose of the transfer of such assets, directly or indirectly to the assessee, was the reduction of a liability to income-tax (by claiming depreciation with reference to an enhanced cost), the actual cost to the assessee shall be such an amount as the Income-tax Officer may, with the previous approval of the Inspecting Assistant Commissioner, determine having regard to all the circumstances of the case."

14 Therefore, sub-section (1) of Section 43 of the Act lays down that actual cost in the hands of an assessee means the actual cost of the assets as reduced by that portion of the cost which may have been met directly or indirectly by any other person. Explanation 3 to the said sub-section stipulates that :

[i] The assets which are acquired by the assessee were used by any other person before the date of acquisition.

[ii] The Income Tax Officer arrives at objective satisfaction that such assets were transferred with the main purpose of reducing tax liability by claiming depreciation with reference to enhanced cost.

[iii] Then the Income Tax Officer is empowered to determine the actual cost having regard to all

the circumstances of the case.

Thus, the Explanation, in fact, extends the meaning of the term "actual cost" in certain circumstances and grants power to the Income Tax Officer to determine the actual cost in hands of the assessee.

15 Hence, it is crystal clear that the assessing officer is obliged to record a satisfaction that the assets were transferred for reducing the liability to pay income tax and for this purpose an appellate authority cannot substitute its opinion to sustain the applicability of the said Explanation 3 only because the assets which are transferred were used by any other person before the date of acquisition. The duty cast upon the assessing officer by the provision is to determine the actual cost and not to substitute a valuer's opinion. At the same time, merely because a document in the nature of contract of purchase is entered into denoting certain price the same would not conclusively establish correctness of the claim made by an assessee if the assessing officer is of the opinion that the transaction is by way of subterfuge or device in order to avoid tax which the assessee is otherwise liable to pay or that the transaction is illusory or colourable or that the assessee has acted fraudulently. In such circumstances, it would always be open to the assessing officer to go behind contract and ascertain the actual cost so as to determine the correct liability to tax. But at the same time, it needs to be emphasized that Explanation 3 does not require determination of market value at the hands of the assessing officer but speaks of determination of actual cost by the assessing officer with prior approval of the Inspecting Assistant Commissioner having regard to all the circumstances of the case.

16 In the present case, crux of the matter thus boils down to as to whether the transaction was entered into by the assessee to reduce its tax liability viz. whether the dissolution had been effected with the main purpose of reducing liability to income tax by virtue of the said transaction. In this context the following findings recorded by the Tribunal assume great importance :

"Now in order to find out as to how much the assessee should pay to the Thakkar Group, the partners of the erstwhile firm thought it fit to get some of its assets valued by a registered valuer xxx xxx xxx"

The Tribunal has further recorded the following facts and figures :

Sr.No.	Assets.	Value in Rupees.	W.D.V.
1	Land.	1,00,000/-	-
2	Factory Bldg.	3,50,000/-	82,523
3	Res.Bldg.	1,50,000/-	35,367
4	Plant & Machinery.	33,68,026/-	6,77,055

It is a common ground between the parties that the assessee has claimed enhanced cost relatable to only three assets viz. factory building, residential building and plant and machinery.

17 The Tribunal, however, held that the total payment made by the assessee was not only in respect of the assets for which the assessee had claimed enhanced cost but was also in respect of good will, tenancy rights etc. In short, the Tribunal considered that the entire transaction and payment was for acquisition of running concern of the erstwhile firm.

18 Having gone through the deed of dissolution we find that in unequivocal terms, when the entire deed is read as one document, it talks about acquisition of only assets and not liabilities. Clause (1) of the dissolution deed, relevant extracts of clause (5) and clause (6) of the deed as are relevant for our purpose are reproduced hereunder :

"1 The partnership firm of M/s.Ashwin Industries hereby stands dissolved from 31st of July 1978 and an account has been made and settled between all the parties of the said firm and the credits, debits, assets, and liabilities of the firm have been determined as per the balance sheet of the said firm and on the dissolution of the said firm, the assets including movable and immovable properties and rights therein and all the plants,

machineries, tools, equipments and the whole block more particularly described in Schedule 'A' and Schedule 'B' hereunder together with all the licences registered trade marks and trade name quotas and all rights incidental thereto together with all the licences to manufacture Vanaspati, import quotas, export quotas, STC Quotas, telephones, telex, tenancy rights and all the premises and offices of all the factory buildings, labour quarters, godowns together with the goodwill as a running concern are allotted to the party of the first part from to-day and they shall be deemed to be the property of the ownership and permanent tenancy rights of the party of the first part in which the parties of the second to eighth part have no right title and interest and the party of the first part has received the possession of the same under the strength of this Deed of Dissolution and the parties of the second to eighth part stands retired from the said firm and its business".

xxx xxx xxx

(5) "As the assets and factory and the running business of M/s. ASHWIN INDUSTRIES together with land, building, plant, machinery etc. as mentioned hereinabove have been allotted on the dissolution of the firm to the party of the first part, the party of the first part has paid and agreed to pay the above referred amount totalling to Rs.37,94,680/- to the parties of the second to eighth part as mentioned hereinabove and it is further agreed between the parties that the parties of the second to eighth part shall pay all the debts and liabilities of the said firm of M/s. ASHWIN INDUSTRIES as shown in the balance sheet, it is also agreed between the parties that parties of second to eighth part shall be entitled to recover all dues from the debtors of the firm of M/s. ASHWIN INDUSTRIES as shown in the said balance sheet".

xxx xxx xxx

(6) As the firm of M/s.ASHWIN INDUSTRIES stands dissolved, the parties of the second to eighth part shall pay and discharge all the liabilities of the firm of M/s.ASHWIN INDUSTRIES. So far as the liabilities of the said firm are concerned, they are shown in the balance sheet and there is no further liabilities, known or unknown to be payable in the names of the said firm and inspite of the same, if there arises any liability or liabilities in the name of the said firm for a period prior the date of dissolution, the parties of the second to eighth part shall pay the same and they shall further see and make all endeavours to see that the party of the first part will not be responsible for the payment of the same in any manner. However, in any case, if the party of the first part has to pay such liabilities or debts, outstanding in the name of the said firm in respect of the parties prior to the dissolution, the parties of the second to eighth part will indemnify the party of the first part for the same together with running interest at the rate of 15% per annum together with cost".

On a conjoint reading of these clauses it is absolutely clear that the assessee company acquired only assets and nothing else. The liabilities of the firm till date of dissolution being taken over by the erstwhile partners with an indemnity in favour of the assessee, that such liabilities shall be discharged by the erstwhile partners viz. other than the assessee company. The finding that the assessee company took over a running business and paid for the same is not borne out by the facts and the said finding runs contrary to the terms of the dissolution deed.

19 In fact, the assessment order is very clear on

this point that all machineries and assets have been taken over as a running concern i.e. the machineries and various assets remained where they were viz. there was no shifting and the assessee company started running the machineries as they were already installed. The assessment order nowhere states that the business as such was taken over by the assessee company. The Tribunal has lost sight of the distinction between a "running business" and a "running concern". A business in its sweep takes in all the assets, liabilities, various outstandings by way of debts incurred and debts due. In the case of the assessee, the entire business is split up into the assets and liabilities and on dissolution the assessee company takes over only assets leaving the liabilities to be discharged by the erstwhile partners viz. other than the assessee company. Thus, payment in question is only for acquisition of the assets.

20 The question then arises is : Explanation 3 to Section 43(1) of the Act only talks of assets which were used by any other person for the purpose of business prior to date of acquisition and are transferred and the main purpose of transfer of such assets is reduction of tax liability by claiming depreciation on the enhanced costs : the assessee having acquired only assets can the provision not become applicable ? First of all, we do not have any finding recorded by any authority to the effect that the main purpose of the transfer was for claiming depreciation at an enhanced cost. Though the Income Tax Officer has stated that dissolution had been effected to defraud the revenue by transfer of assets of the firm to the company what is more material and necessary is that there is no finding to the effect that the enhanced cost was incurred with the main purpose of reduction of liability to income tax by claiming depreciation on the enhanced cost. In fact, the assessee has not claimed depreciation on enhanced cost of all assets but only in relation to three assets and more significantly such enhanced cost is supported by valuation report obtained prior to the point of time of the dissolution. The valuation report is by a registered valuer. Neither in the assessment order nor in the Tribunal's order is there any whisper that the valuation report by the registered valuer is incorrect in any manner whatsoever. Once there is a report by the registered valuer it is incumbent upon an authority to dislodge the same by bringing adequate material on record in the form of departmental valuation report, because in absence of the same a technical expert's opinion (registered valuer's report) cannot be dislodged by any authority by merely ignoring the same. In the present

case that is what has happened. Neither the assessing officer nor the Tribunal have even attempted to state that the valuation report and the values put on the assets are incorrect in any manner whatsoever. They have simply ignored the valuation report.

21. The assessee having made a claim for depreciation on enhanced cost, which is actual cost in its hands, it was necessary for the authority who wanted to determine the 'actual cost` (as required by Explanation 3 to Section 43 of the Act) to place some evidence on record. It could not have substituted its opinion and adopted book value or the written down value in hands of the assessee company. As can be seen from the Explanation 3 to Section 43(1) of the Act, the Income Tax Officer is required to determine actual cost to the assessee having regard to all the circumstances of the case and if in his opinion the written down value was the actual cost, he ought to have supported the same by placing sufficient evidence so as to dislodge the valuation report of the registered valuer. On his having failed to do so, even if the earlier portion of the provision, viz. the condition of the assets having been used by another person before the date of acquisition stands fulfilled the provision cannot be applied.

22 Considering the matter from another angle, the Income Tax Officer has merely stated that the dissolution was a method adopted to defraud the revenue but nowhere is it stated that the main purpose of transfer of such assets was for claiming depreciation with reference to enhanced cost. The Tribunal has in para 13 of its order referred to various figures of carried forward business loss, carried forward unabsorbed depreciation and investment allowance etc. in support of its conclusion but it has lost sight of the fact that these are all incidents or effects of the transaction and not the purpose. As can be seen from the assessment order for assessment year 1980-81, the Income Tax Officer himself has allowed the unabsorbed depreciation and business loss as well as investment allowance to be carried forward. Similarly for assessment year 1981-82 the Income Tax Officer himself has deducted the aforesaid items which remained unabsorbed in the preceding assessment year to be set off against the income from business computed for assessment year 1981-82. Therefore, the assessing officer has never considered that the transaction was entered into with a view to reduce tax liability by claiming set off of unabsorbed depreciation, carried forward business loss and investment allowance, and rightly so in our view, as Section does not stipulate

that the main purpose of the transfer of assets is to reduce income tax liability by setting off various items of brought forward loss etc.

23. The Tribunal was therefore not right in law in holding that the assessee was not entitled to claim depreciation on the enhanced value of the assets having regard to the relevant provisions of the Act.

24. Before parting we may make it clear that though the aspect of "transfer" was discussed at great length during the course of hearing, we have not found it necessary to go into the same having regard to the view which we have taken in relation to the applicability of provision of Explanation 3 to Section 43(1) of the Act.

25. The question referred to us is therefore answered in the affirmative i.e. in favour of the assessee and against the revenue.

26. The reference stands disposed of accordingly. There shall be no order as to costs.

Sd/- Sd/-
(B.C.Patel,J) (D.A.Mehta,J)

m.m.bhatt